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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 6, 2001

Magalie R. Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: *Ex Parte*
CC Docket No. 01-117

Dear Ms. Salas:

Pursuant to Sections 1.1206(a) and (b) of the Commission's rules this will provide notice that on September 5, 2001, the undersigned met with Dorothy Atwood and Michelle Carey of the Common Carrier Bureau concerning issues in the above-captioned proceeding. I presented views described in the attached "Supplemental Comments" of Mpower Communications Corp., which was provided at the meeting.

Sincerely,

Francis D R Coleman

Francis D. R. Coleman
Vice President, Regulatory Affairs

cc: Dorothy Attwood
Michelle Carey

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)	
	)	
	)	
Petition of Mpower Communications Corp. for	)	
Establishment of New Flexible Contract	)	CC Docket No. 01-117
Mechanism Not Subject to "Pick and Choose"	)	

SUPPLEMENTAL COMMENTS

MPOWER COMMUNICATIONS CORP.

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September 5, 2001

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A. INTRODUCTION

As local competition continues to develop, the incumbent local exchange carriers' ("ILECs'") wholesale activities are experiencing growth rates faster than the ILECs' retail activities. This growth in the ILECs' wholesale activities appears to be altering the relationship between ILECs and competitive local exchange carriers ("CLECs") that are resellers and/or unbundled network element ("UNE") based. Specifically, Mpower will show that increasingly the relationship between ILECs, resellers and UNE-based[1] CLECs is being recognized as a symbiotic wholesaler-retailer relationship rather than as a "zero-sum" competitor-to-competitor relationship. In view of this, Mpower urges the FCC to grant Mpower's petition including initiation of a rulemaking proceeding to establish a mechanism, referred to by Mpower as FLEX contracts, that allows ILECs and CLECs to negotiate mutually beneficial terms and conditions for interconnection. While under Mpower's proposal ILECs and CLECs will be able to negotiate contracts free from the strictures of the current "pick-and-choose" regime,[2] it is important to note that Mpower's proposal is not an effort to replace the current regime of mandatory unbundling of the ILECs' network at TELRIC-based prices. To the contrary, the continued availability of TELRIC based UNEs remains an absolutely essential safety net for CLECs. Mpower's proposed FLEX contracts should be viewed, therefore, not as substitutive of, but as ancillary to, the current regime.

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[1] In these comments, the term "UNE-based CLECs" refers, except when noted to the contrary, to CLECs that use the ILECs network to provide services.

[2] The "pick and choose" requirement should not apply to voluntary FLEX contracts because it would inhibit mutually beneficial FLEX contract relationships between CLECs and ILECs by requiring ILECs to negotiate on the basis of making a concession to all CLECs rather than to the individual CLEC participating in the voluntary FLEX contract negotiation in question. In this connection, it is noteworthy that the resale interexchange market grew dramatically after the Commission permitted AT&T some flexibility to establish individual customer arrangements in AT&T's Tariff 12 offerings. FLEX contracts not subject to "pick and choose" could encourage similar results for wholesale arrangements between ILECs and CLECs.

B. The Telecommunications Act of 1996 Promotes Competition by Means of Wholesale Relationships Between the ILEC and Its Would-Be Competitors

In its *Local Competition Order*,[3] the FCC notes that the Telecommunications Act of 1996 (the "1996 Act") envisions that carriers will enter local markets with diverse strategies. Some carriers will build their own facilities, other carriers will lease facilities from the incumbents, and yet others will pursue a hybrid strategy that involves the construction of new facilities and leased facilities. As the FCC states:

> The Act contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale. The 1996 Act requires us to implement rules that eliminate statutory and regulatory barriers and remove economic impediments to each.[4] (Emphasis added.)

As a result of the pro-competitive provisions of the 1996 Act and the efforts of federal and state regulators, the telecommunications industry has gone through a dramatic transformation and, to a growing degree, local entry is occurring in the various forms anticipated by the framers of the 1996 Act. In New York State, for example, one can find CLECs that provide service mostly over their own facilities, CLECs that are resellers or UNE-based providers, and CLECs that provide service over a combination of their own facilities and the ILECs' facilities.

Mpower would like to focus here on the wholesale relationship between the ILEC and CLECs that use the incumbent's facilities to offer services. In its *Local Competition Order* and a large number of subsequent orders, the FCC has spent an enormous amount of time and energy on constructing a functioning regulatory framework to govern this wholesale relationship between the ILEC and CLECs. As the FCC recognizes in various orders, because the ILECs have traditionally viewed the CLECs as both customers and competitors, this wholesale relationship is often strained by the ILEC's countervailing incentives: while the ILEC may be inclined to promote its wholesale business -- and it

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3 *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499, 15509, (1996) *("Local Competition First Report and Order")*

4 *Id.*, paragraph 12.

does -- it also has had an incentive to handicap its would-be competitors in order to protect its own retail business.

There are growing indications that with the further development of local competition, ILECs will increasingly view resellers and UNE-based CLECs as customers and not just as competitors. As discussed in more detail below, the ILECs' annual and quarterly financial reports show that their wholesale business is growing faster than their retail business. Further, various ILECs have publicly recognized that UNE-based CLECs can be valuable allies in ensuring that end users do not migrate to the competing networks of, say, cable companies. These developments are encouraging, since they are signs that local exchange markets are slowly beginning to behave consistent with competitive market principles.

At this juncture, therefore, it is important to introduce a mechanism that will allow ILECs and CLECs to become wholesale *partners*. To this purpose, Mpower has filed its petition requesting initiation of a rulemaking to establish "FLEX contracts." As discussed in more detail in the Mpower petition, FLEX contracts are flexible arrangements, free from the strictures of "pick-and-choose" so that ILECs and CLECs could develop terms and conditions for interconnection based on their mutual interests in the wholesale partnership.[5] FLEX contracts could be a "win-win-win" solution because they would be good for ILECs, good for CLECs and good for their customers.

C. As Competition Develops, ILECs, Resellers and UNE-Based CLECs Should Develop a More Symbiotic Wholesaler-Retailer Relationship

As local competition continues to develop, ILECs are increasingly being confronted with a spectrum of competitors, ranging from competitors that use the ILECs' network facilities, such as resellers and UNE-based CLECs, to competitors that almost exclusively offer service over their own facilities, such as cable companies.

In considering the ILECs' potential responses to competitive entry, it is important to recognize that each form of competition impacts the ILECs' revenues and profits differently. In the case of competitors that offer service entirely over their own

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[5] *See* n. 2, *supra*.

networks, the *ILECs stand to lose literally all of the revenues and profits associated with the end user*. By contrast, when competitors use in whole or in significant part the ILECs' facilities, the ILECs' loss of an end-user customer results only in a partial loss of revenues and profits. Thus, in determining their posture towards resellers and UNE-based CLECs, the ILECs must consider the choice between wholesaling or losing all sales altogether. As competing networks continue to develop, the choice for the ILECs is increasingly "wholesale or no sale."

The spectrum of competition and the implications for the ILECs' revenues and profits may be illustrated as below.

Again, the important distinction here is between competitors that use the ILEC's facilities, such as UNE-based CLECs and resellers, and those that operate or use competing networks. As long as the ILEC wholesales its facilities to a competitor, *it will retain part of the revenues and profits associated with the end user*. Specifically, the ILEC will retain the wholesale-related revenues and profits.

D. ILECs Benefit In Various Ways From A Wholesale Alliance With Resellers and UNE-Based CLECs

In addition to retaining the wholesale-related revenues and profits, ILECs will experience additional benefits from their wholesale relationship with resellers and UNE-based CLECs. The ILECs' full benefits of wholesaling are twofold:

- ILECs will continue to earn revenues and profits from wholesaling their network even where the growth of certain segments of their retail customer base may be stagnating. Wholesaling to CLECs also ensures continued utilization of the ILECs' networks and avoids their having to incur costs for maintaining facilities that are unutilized. This is a significant benefit given the predominantly *fixed-cost* nature of telecommunications facilities. In most other industries, a lost customer typically means a corresponding reduction in costs. Not so in the telecommunications industry. Once the network is built, the majority of a carrier's network costs are fixed and will be incurred whether or not there is a customer. The loss of a customer, therefore, does not result in a zero profit, but rather in a negative profit. It is for this reason, among others, that wholesale should be an attractive alternative to losing an end user altogether.

- In establishing a close relationship with resellers and UNE-based CLECs, the ILEC strengthens its competitive position vis-à-vis competitors that use or operate competing networks. Most importantly, by nurturing its wholesale relationship with resellers and UNE-based CLECs, the ILEC benefits from the resellers' and

CLECs' retailing activities. That is, the retailing, marketing and advertising activities of competitors that use or operate competing networks now need to match the combined level of activity of the ILEC, resellers and UNE-based CLECs. In short, a close and healthy wholesale relationship between ILECs, resellers and UNE-based CLECs could greatly enhance the ILEC's overall competitive position in the market place.

One should note that each of these effects is amplified in importance as facilities-based local competition grows in importance.

E. Indications Are that ILECs Are Increasingly Valuing Their Wholesale Customers

Undeniably, ILECs will continue to prefer, as they have in the past, to retail directly to end users -- the revenues and profits associated with retailing vertical features and certain business services remain high. This explains, in part, why most ILECs have some form of win-back programs in place by which they seek to bring lost customers back onto their networks.

Nevertheless, as the industry evolves and becomes more competitive, one would expect that the ILECs become naturally more interested in nurturing relationships with entities that are able to efficiently retail their network services to end users. In this sense, the vertically integrated ILECs may gravitate toward the model followed in other capital intensive industries, such as the automobile industry, where GM, Ford and other manufacturers have close and well developed relationships with independent dealers that perform many of the retail functions necessary to sell cars to end-user customers. In fact, we may already be witnessing a change in this direction.

For example, at least two of the four RBOCs, BellSouth and Qwest, appear to have programs in place under which *they pay commissions to their sales representatives for sales of TELRIC-based UNEs to CLECs*. This is most interesting because it may signal that the ILECs are starting to recognize that the wholesale business: (a) is profitable (why else promote it through sales commissions), and (b) that they have an interest in keeping customers on their networks, either as their own end users or as end users served by resellers or UNE-based CLECs.

The same change in attitude can be gleaned from statements made by ILEC representatives in legal pleadings, speeches, etc. The following statement taken from

Qwest's comments before the FCC is illustrative of how ILECs may be viewing the changing role of wholesale:

> ... ILECs and CLECs alike have an economic incentive to work together to maximize the competitiveness of DSL offerings. Qwest is trying to engage in such joint efforts at this time. If an ILEC, in a competitive broadband market place, were to try to behave in a manner which discouraged other providers of DSL services from optimizing their own services over the ILEC's loops, customers could simply purchase broadband services from cable providers. [6]

Qwest then goes on to note

> [I]t is also important to keep in mind that CLECs still need access to ILEC loops in order to provide DSL services. It would be a serious mistake, in today's marketplace, to allow a situation to develop whereby CLECs were unable to make efficient use of ILEC loops. Such a situation would harm both CLECs and ILECs alike.[7]

Another illustrative statement is the one made by a Verizon officer in a recent speech before the *Progress and Freedom Foundation*:

> Now, unlike some other network providers, Verizon is willing to make our network available to other players, even competitors; in fact, we see the wholesaling of our network as a legitimate business opportunity as long as we're permitted to operate this business on rational economic and technical grounds.[8]

These statements made by Verizon and Qwest articulate the changing role of wholesale in the competitive market place. As discussed in more detail in Mpower's petition requesting a rulemaking to establish FLEX contracts, the current UNE regime that rules interconnection agreements between ILECs and CLECs – although essential for UNE-based CLEC survival -- is too restrictive and does not allow parties sufficient flexibility to nurture closer and voluntary wholesale relationships.

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6 Comments of Qwest Communications International Inc. On Further Notice of Proposed Rulemaking, CC Dockets Nos. 98 – 147, 96 – 98. Page 3.

7 *Id,* Page 3.

8 Tom Tauke, Senior Vice President Public Policy and External Affairs Verizon Communications, "Delaying the Last Mile," Speech delivered before the *Progress and Freedom Foundation*, Aspen, August 21, 2001.

F. ILECS ARE ENGAGED IN SIGNIFICANT WHOLESALE ACTIVITIES WARRANTING A ROLE SUPPORTIVE OF RESELLERS AND UNE-BASED CLECS

Attached to this paper are some select RBOC data on local exchange carrier revenues and wholesale and retail access line counts. These data show that RBOCs are experiencing significant growth in their wholesale activities. As the FCC is well aware, however, detailed data on competitive entry is often highly proprietary and therefore extremely hard to obtain. The data presented here are gathered from public sources and are not intended to be a comprehensive review of the state of competition. Rather, they are presented to show instances in which ILECs are experiencing increased wholesale activities and therefore should have an incentive to nurture closer wholesale relationships with resellers and UNE-based CLECs, as discussed above.

Undoubtedly, the development of local competition is still heavily influenced by regulatory policies. Given that state commissions are independent and do not move in tandem, a review of the status of competition across the country shows a fairly uneven development. Nevertheless, data show significant wholesale activity in various markets.

At this point it appears that the New York market is perhaps the most competitive one. According to recent testimony filed by Verizon, there is significant competitive entry in the New York market:

> Verizon estimates that well over *3 million access lines* in its operating area in New York are served by competitive local exchange providers[9]... Facilities-based competitors currently provide about *1.15 million business and 121,000 residence lines* and are present in wire centers that serve over 90% of Verizon's business lines and 64% of its residence lines, respectively. Competitors are growing rapidly and growth has accelerated since Verizon NY's entrance into the interLATA market became imminent.[10] (Emphasis added.)

Verizon then goes on to discuss that a significant portion of this competition consists of competitors that use or operate competing networks. While these data have not been subjected to cross-examination, they indicate that: Verizon in New York is

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[9] NYPSC Case 00 – C – 1945, Verizon Panel testimony, May 15, 2001. Page 10.

[10] *Id.*, page 73.

experiencing significant wholesale activity where there are competing networks. The New York market, therefore, is perhaps the best illustration of a situation in which the incumbent, Verizon, is faced with what Mpower calls the "retail, wholesale, or no-sale" proposition. The same observation can be made for BellSouth, which claims to have lost 1.8 million lines serving area-wide to competitors that use or operate competing networks.[11] As discussed, the worst scenario for the ILECs in this spectrum of competitive possibilities is the "no-sale" outcome: a "no-sale" outcome leaves the ILEC without any revenues to cover the ongoing fixed costs of its network and operations.

While the competitive situation appears most intense in New York State, the same pattern of the wholesale business developing into an increasingly important segment of the ILECs operations is found across the country. For SBC, BellSouth and Verizon, the relative recent growth in their retail and wholesale operations has been as follows:

Table 1:
Growth in Local Service Revenues (For the Six Months Ended June 30, 2001 Versus June 30, 2000), and Change in Retail and Wholesale Access Lines As of June 30, 2001 Versus June 30, 2000[12]

	SBC % CHANGE	BELLSOUTH % CHANGE	QWEST % CHANGE	VERIZON % CHANGE
LOCAL SERVICE REVENUE				
TOTAL	**8.4%**	**2.7%**	**NA**	**1.8%**
ACCESS LINES SERVED				
RETAIL	**15.1%**	**24.9%**	**N/A**	**20.7%**
WHOLESALE	**55.6%**	**42.7%**	**N/A**	**31.0%**
TOTAL	**15.9%**	**25.2%**	**29.9%**	**21.0%**

These numbers reflect some important developments. As indicated, for SBC there was a 55.6 percent year-over-year increase in wholesale lines as of June 30, 2001. Through the 2nd Quarter ending June 30, 2001, *growth in wholesale activities accounted for no less than 20 percent of the overall growth in SBC's local service revenues*

[11] BellSouth, Communications Group, 2nd Quarter, 2001 10Q.

[12] 10Qs, 10Ks, Annual Reports and Investor Briefings. More detailed data are found in the attachment.

compared to the same six-month period in 2001.[13] This number is even more startling if one realizes that wholesale growth is typically more concentrated in select geographic areas than retail growth. This means that in certain areas, growth in SBC's wholesale revenues may have possibly exceeded growth in SBC's retail revenues. This is an important development, underscoring the increasingly important role of the ILEC/CLEC wholesale relationship.

SBC's situation is not unique. For Qwest, wholesale drove *25 percent* of the year-over-year growth in revenues for the company, as of the 2nd Quarter, 2001.[14] In general, as the table above indicates, for SBC, BellSouth, and Verizon, growth rates for the wholesale business significantly outpaced those for the retail business.

To put the percentage growth rates in perspective, however, the table below shows the relative number of retail and wholesale access lines served by those companies as of the end of last year. Also shown are the total local service revenues for these companies:

Table 2:
Local Retail Revenues, Retail Access Lines and Wholesale Access Lines
(as of 12/31/2000)[15]

	SBC	BELLSOUTH	QWEST	VERIZON
LOCAL SERVICE REVENUE				
TOTAL	**$22.1 B.**	**$12.6 B.**	**N/A**	**$21.4 B.**
ACCESS LINES SERVED				
RETAIL	**103,456,000**	**54,229,000**	**N/A**	**108,833,000**
WHOLESALE	**1,633,000**	**1,308,000**	**N/A**	**3,543,000**
TOTAL	**105,089,000**	**55,537,000**	**41,861,000**	**112,376,000**

The above tables show that while wholesale is still small relative to the ILECs' total retail activities, it is among the fastest growing segments of the ILECs' operations.

13 SBC, 2nd Quarter, 2001 10Q.

14 Morgan Stanley Dean Witter, "Qwest: 2Q01 Largely In Line, but Surprises Below the Line," *Telecom – Wireline* – August 21, 2001.

15 10Ks, Annual Reports and Investor Briefings. More detailed data are found in the attachment.

As noted, attached to this document are more detailed data that break down wholesale activities for SBC, BellSouth and Verizon. The important observation, however, is that the fast growing wholesale business allows the ILECs to retain end users on their networks rather than to lose them to competitors that use or operate competing networks. As this trend continues, we should expect the ILECs to become increasingly interested in developing closer ties with their resellers and UNE-based CLECs.

G. CONCLUSION

While ILECs are experiencing significant growth in their wholesale business, there is continued growth in competing networks. In view of this, ILECs will increasingly be interested in developing close relationships with resellers and UNE-based CLECs. To accommodate the need of ILECs and CLECs to engage in mutually agreeable terms and conditions for interconnection, the FCC should promptly grant Mpower's petition including initiation of a rulemaking proceeding to establish a mechanism, referred to by Mpower as FLEX contracts. Again, while under Mpower's proposal, ILECs and CLECs will be able to negotiate contracts free from the strictures of the current "pick-and-choose" regime, Mpower's proposed FLEX contracts should be viewed as ancillary to, and not as substitutive of, the current regime. As such, the FLEX contracts proposed by Mpower would be a "win-win-win" solution that is good for ILECs, good for CLECs and good for their customers.

Respectfully submitted,

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September 5, 2001

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Supplemental Comments have been served by hand delivery to the persons listed below on this 5th day of September, 2001.

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